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IN THE

Supreme Court of the United States

October Term, 1940

No. 335

ALAMITOS LAND COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

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October Term, 1940

No. .....

ALAMITOS LAND COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

The petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above entitled cause on June 10, 1940, reversing an order of the United States Board of Tax Appeals.

Opinions Below.

The opinion of the United States Board of Tax Appeals was rendered July 28, 1939, Record pages 23 to 50, and is reported in 40 B. T. A. 353. The opinion of the Circuit Court of Appeals, Record pages 138 to 148, inclusive, is reported in 112 Fed. (2d) 648.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on June 10, 1940, Record 149. The jurisdiction of this Court is invoked under Section 240-a of the Judicial Code as amended by Act of February 13, 1925.

Questions Presented.

1. Whether, under the circumstances of this case, petitioner realized taxable income in the year 1932 when it received the amount of $522,895.11 paid to it by Shell Oil Company during the pendency of a court controversy under compulsion of a court order later determined to be erroneous, which determination required petitioner to return the money to Shell. Petitioner's average income, against which the restitution might be deducted, was about $60,000 a year.

2. If the receipt in 1932 constituted income to petitioner, was petitioner taxable on more than 65% of such receipt, when it had previously agreed to pay to Shepard-Pendleton, Ltd. 35% of any recovery in the litigation?

3. Whether petitioner realized taxable income in the years 1932 and 1933 on account of interest accrued on the $522,895.11 which had been placed on time deposit by petitioner pending the outcome of the litigation, said interest having been turned over to Shell on the reversal of the lower court's decision.

4. If petitioner is taxable on the interest on said litigated fund, is it taxable on more than 65% thereof, when it had the contractual obligation to pay to its associates 35% of any recovery?

Statute Involved.

Section 22(a) of the Revenue Act of 1932, reads as follows:

> "(a) General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

Statement.

This case involves income tax deficiencies for the years 1932 and 1933 of $28,978.21 and $2,478.93 respectively [Record, p. 4] resulting from the determination of respondent, the Commissioner of Internal Revenue, that petitioner received taxable income in 1932 from the receipt of monies paid to it by Shell Oil Company during the pendency of a court controversy under compulsion of a court order later determined to be erroneous, and from the determination of the Commissioner that interest realized on said fund (which was placed in a special account), was taxable income to the petitioner for the years 1932 and 1933.

In 1921 petitioner leased to Shell Oil Company certain land for the development of oil and gas upon a royalty of 16-2/3% of the oil and gas produced and saved, which royalty was payable monthly. The property has been producing oil and gas since 1921 [R. 21] and since that

time petitioner has accrued as income on its books and tax returns in December of each year the December royalty, payable in January. [R. 74.]

On September 1, 1930, petitioner entered into a written contract with Shepard-Pendleton, Ltd. a corporation engaged in petroleum engineering work, by the terms of which Shepard-Pendleton was engaged to check the method which Shell had used in determining the quantity and quality of the oil produced from the leased premises and the methods of computing the royalties to be paid to petitioner. [R. 65.] Petitioner agreed to pay to Shepard-Pendleton for its services a sum equal to 35% of the amount recoverable from Shell whether with or without litigation, Shepard-Pendleton was to pay all attorney's fees and court costs. [R. 74.] The agreement related only to oil and gas and gasoline produced, saved and sold under the lease up to but not including September 1, 1930. [R. 78.] Shepard-Pendleton checked the method by which Shell had determined the quantity and quality of oil produced on the leased premises for the purpose of computing royalties and caused to be brought on behalf of petitioner in 1931 a suit against Shell for additional royalties up to August 30, 1930, and for the cancellation of the lease on the ground that Shell had failed to make proper accounting of royalties. [R. 65-66.]

In April, 1932, the Superior Court of the State of California gave judgment to petitioner, the plaintiff in said suit, in the amount of $522,895.11, representing additional royalties from the date of discovery of oil in 1921 to September 1, 1930, in the amount of $490,805.75, together with interest in the amount of $31,226.86 and court costs of $862.50. The judgment also declared the termination

of the lease but provided that Shell would be relieved of such forfeiture in the event it paid to petitioner on or before August 29, 1932, all sums for which judgment was given. [R. 66.]

Shell, in order to prevent a forfeiture, tendered to petitioner on July 8, 1932, a cashier's check for $522,895.11. Acompanying said check was a letter from Shell to petitioner which stated that the payment of said sum was made only in order to avoid the forfeiture decreed by the judgment and was made involuntarily and solely by virtue of the duress, coercion and compulsion of the judgment, and that Shell did not in any way relinquish its rights of appeal from any and all parts of said judgment or to recover the payment of said sum given to the extent that said judgment might be reversed or modified upon appeal, or to take such other step or action as Shell might deem appropriate to protect itself and its interests in the premises. [R. 66-67, 91-92.]

On July 14, 1932, Shell took an appeal to the Supreme Court of the State of California from all portions of the judgment of the Superior Court with the exceptions of Paragraphs 6 and 7 thereof. Petitioner took an appeal to the said Supreme Court from Paragraphs 6 and 7 of the judgment. [R. 67.]

Petitioner, on September 22, 1932, deposited the check for $522,895.11 in a Long Beach Branch of the Security-First National Bank of Los Angeles, in a time deposit account bearing interest at the rate of 3½% per annum. [R. 69.] Upon its books petitioner made a journal entry debiting "Deposit in connection with pending action vs. Shell Oil Company—$522,895.11" and crediting "Reserve for contingent liability in connection with pending action

vs. Shell Oil Company—$522,895.11." The journal entry then contained an explanation reciting the conditions under which Shell made the payment, and that with the approval of Shepard-Pendleton "who has a considerable interest in the amount of said judgment" the funds were deposited as mentioned above. [R. 106-107.]

In its 1932 income tax return, petitioner excluded from income the amount received from Shell and the interest earned thereon, explaining in a statement attached to the return the entire situation; further stating that the funds must be held intact until there was a final determination of the case by the higher courts. [R. 74-75.] In its 1933 return, petitioner excluded from taxable income the $18,-208.57, increase in funds in the special account, stating that no portion of said funds had at any time been considered or used as income, the deposit being kept intact pending decision by the State Supreme Court. [R. 76.]

On April 26, 1935, the Supreme Court of California reversed the judgment of the lower court in the portions of the judgment which were in favor of petitioner and affirmed said judgment as to the portions thereof which were in favor of Shell. The Court remanded the cause for further proceedings in accordance with its holdings. [R. 70.]

On June 4, 1935, petitioner paid to Shell, in compliance with the latter's demand for restitution, the sum of $522,895.11 plus $41,256.90, being the interest actually received by petitioner during the time said principal had

been in its custody, and the sum of $11,595.31, representing profits accruing from the purchase and sale of United States Treasury notes. [R. 70.]

In 1935 petitioner filed an amended complaint against Shell in the Superior Court and Shell, after a motion to dismiss said amended complaint had been denied, filed an answer, leaving the case at issue in the spring of 1938. [R. 71.]

While the case was pending trial, the parties, in 1938, entered into an agreement settling the case whereby petitioner received $100,000, each party paying its own court costs. Petitioner settled with Shepard-Pendleton, Ltd. by paying them $25,000.00, and paid special counsel employed in connection with the litigation $2,500. [R. 73.]

In its 1935 return, petitioner did not claim any deduction on account of having returned to Shell the $522,895.11 plus accretion, but after paying a Federal income tax of $7,081 for 1935, petitioner filed a claim for refund for that year for $7,081 on the ground that if the $522,895.11 was held to be taxable income to the petitioner in the year 1932, said amount would be deductible in 1935. This claim was filed before petitioner settled its litigation with Shell but has not been acted upon by the Commissioner of Internal Revenue. Petitioner's income for 1935, without any deduction on account of the restitution to Shell, was $51,498.18. [R. 73-74.]

It was estimated at the trial that petitioner would have a taxable income in 1938 of $114,463.75 including the

$100,000 received from Shell in the settlement of the litigation and after deducting attorney's fees of $27,500.00 and depletion of $27,500.00 on the $100,000 received from Shell. It was further estimated at the trial that petitioner would have a net taxable income in 1938, without regard to any items in connection with the Shell litigation, of $69,463.75. [R. 123, 125.] Petitioner's income for 1932 and 1933, without regard to the Shell litigation, was $70,410.47 and $48,210.21 respectively, its average income being around $60,000 a year. [R. 12-13.]

Specification of Errors to Be Urged.

The court below erred:

1. In holding that petitioner received taxable income in 1932 on account of the receipt of monies from Shell.

2. In failing to hold that 35% of said monies received from Shell was, if taxable income to anyone, the income of Shepard-Pendleton, Ltd., and not that of petitioner.

3. In holding that petitioner received taxable income in 1932 and 1933 in the form of interest on the fund received from Shell.

4. In failing to hold that 35% of the interest from the Shell fund if not taxable to Shell was taxable income to Shepard-Pendleton, and was not the taxable income of petitioner.

Reasons for Granting the Writ.

1. The court below has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

In *Eisner v. Macomber,* 252 U. S. 189, this Court defined income subject to taxation under the Sixteenth Amendment and under the Revenue Act, and held that the attempt to tax anything else under the income tax law would violate the provisions of Article 1, Section 2, Clause 3, and Article 1, Section 9, Clause 4 of the Constitution, prohibiting the laying by Congress of direct taxes without apportionment. This Court said that what is and what is not income is to be determined according to truth and substance, without regard to form. The Court pointed out in its definitions of income that it must be gain derived from capital or labor, or both combined; it must proceed from the property, be severed from the capital and be received or drawn by the recipient for his own separate use, benefit and disposal. This Court pointed out, in considering whether a stock dividend was income, that it would be necessary to sell some of the stock in order to pay the tax and nothing could more clearly show that to tax the stock dividend was to tax capital increase and not income, than that in the nature of things it requires a conversion of capital in order to pay the tax.

In the case at bar, the petitioner received money from Shell with notice that it was paid under protest and that Shell intended to attempt to get it back on appeal. Peti-

tioner did not treat the money as its own on its books or otherwise but segregated it as a fund which might have to be returned. Petitioner was required to return the money and if it has to pay tax on the receipt, it will have to pay it out of its other capital funds. It cannot pay it out of its saving in tax in the year in which it paid the money back as its income was so small that the tax saving in that year would be insufficient by a large margin to pay the tax.

In *Bowers v. Kerbaugh-Empire Company*, 271 U. S. 170, this Court held that in determining whether an item was income, it was necessary and proper to look at the entire history of the transaction even though it might cover a period of years. In that case the taxpayer had borrowed money in 1913, repayable in German marks. The money had been lost in business transactions but the loan was repaid in depreciated German marks and at an apparent book profit. This Court held that where the result of the whole transaction was a loss, the mere diminution of the loss was not gain, profit or income. The Court pointed out that although the taxpayer, or its subsidiary company, took deductions for the losses in the several years in which they were sustained, these deductions did not benefit it from a tax standpoint as it had losses before these deductions were taken.

In the case at bar, over the entire period of years involved, the petitioner did not actually gain anything from its litigation with the Shell Company excepting the money which was received in 1938 on the settlement of the litigation. It is, of course, willing to pay tax on its portion of that sum in whatever year it is proper to do so. The right to take a deduction in the year of restitution or

settlement of the amount received from Shell does not make the receipt in 1932 taxable income as the deduction would not benefit taxpayer for income tax purposes since its income was greatly inadequate to this deduction.

In *Freuler v. Helvering,* 291 U. S. 35, the beneficiaries of a trust received from the trust amounts in excess of the distributable income to which they were entitled but were later required to return the excess to the trustee. This Court held that the beneficiaries were taxable only on the amounts which should have been distributed to them, on the theory that the test of taxability to the beneficiaries was not the receipt of income but the present right to receive it and that an overpayment to the beneficiary by mistake of law or facts would render him liable not on the amount paid but on that payable.

Petitioner received the money from Shell on a mistake of law and had to return it, or in the long run, part of it, and should, under the authority of the *Freuler* case, be taxable only on the amount which should have been paid to it.

In *United States v. Safety Car Heating and Lighting Company,* 297 U. S. 88, and *Sanford and Brooks,* 282 U. S. 359, this Court held that amounts in litigation were not taxable income to the eventual recipient until its right thereto had been upheld by the highest court of appeal or settlement.

There is no reported case of a taxpayer receiving money in litigation and eventually being required to pay it back wherein this Court held that the temporary receipt was taxable income.

2. The court below has decided an important question of local law in a way probably in conflict with applicable local decisions. Under California law, an executory contract between two parties that one should have as compensation for services, a stipulated percentage of the proceeds of a judgment to be recovered for the other, operates as an equitable assignment *pro tanto*. *Hoffman v. Vallejo,* 45 Cal. 564; *Luco v. DeToro,* 91 Cal. 405, 27 Pac. 1082; *Elliott v. Leopold Mining Company,* 52 Cal. 355. To the same effect, generally, see *Wooster v. Trowbridge,* 120 Fed. 667; *Hawk v. Ament,* 28 Ill. App. 390; *Driband v. Candler,* 166 Mich. 49, 131 N. W. 129; *Bent v. Lipcomb,* 45 W. Va. 183, 31 S. E. 907; *Curtis v. Metropolitan Street Railway Company,* 118 Mo. App. 341, 94 S. W. 762; *Texas C. R. Co. v. Andrews,* 28 Tex. Civil Appeals 477, 67 S. W. 923; *Coughlin v. N. Y. C. and H. R. R. Company,* 71 N. Y. 443, 2 A. L. R. 454.

In the case at bar, petitioner agreed to pay to Shepard-Pendleton, Ltd. 35% of any amount recovered from Shell. Should the receipt from Shell in 1932 constitute income, 65% thereof only would constitute income to the petitioner and 35% to Shepard-Pendleton, Ltd. The court below held that the entire amount received from Shell was taxable in 1932 to petitioner.

3. The decision of the court below is in conflict with *Great Southern Life Insurance Company v. Commissioner,* 89 Fed. (2d) 54, wherein the court affirmed without discussion the decision of the Board, 33 B. T. A. 512, that the taxpayer there involved was not taxable upon interest received on bonds held by it but which bonds it subsequently had to pay over to the rightful owner on a court order. There, the taxpayer had loaned $95,000 to one

Toombs, secured by bonds of the village of Lansing, Illinois, of a par value of $120,000. By December 31, 1928, interest had accrued on said loan in the amount of $4867.22. As of December 31, 1928, the taxpayer appropriated the bonds of the value of $99,867.22 to its own use, marking the indebtedness as having been paid as to principal and interest. Prior to appropriating the bonds as mentioned above, a bank in Illinois had notified the taxpayer that some of the bonds had been stolen from it and had demanded the return of them. The taxpayer refused to turn the bonds over to the said bank and the bank sued the taxpayer and the court awarded to the bank, bonds of the par value of $52,500, which the taxpayer turned over to the bank. The taxpayer had included in taxable income in 1928 the interest from the bonds of the par value of $52,500 which it subsequently gave up. The Board of Tax Appeals held that the taxpayer was not taxable on the interest allocable to the $52,500 in bonds which it subsequently had to give up. The Circuit Court of Appeals for the Fifth Circuit affirmed the decision of the Board without discussion of this point.

In the case at bar, the petitioner received the monies from Shell after Shell had notified it of its intention to attempt to recover the money and the petitioner was required to return the money to Shell.

4. The decision of the court below is in conflict with *Commissioner v. Turney,* 82 Fed. (2d) 661. In that case a bonus for granting an oil lease was received in one year, but the taxpayer was taxed on only one-half thereof. The lease provided that the bonuses would be paid to the lessor who would pay one-half of them over to the State of Texas if, by decision of the Supreme Court of Texas,

it should thereafter be determined that the state was entitled to a portion of the bonuses.

When the bonus was received by the taxpayer Turney, he used it generally in his business and has never paid any part of it over to the State, back to the lessee, nor to anyone else. The State of Texas sued the lessee for a half of the bonus and the lessee made a demand in writing upon Turney that he either pay a half of the bonus to lessee or to the State. It is entirely possible of course that the Supreme Court of Texas will hold against the State of Texas and not require the lessee or Turney to pay to the State of Texas one-half of the bonus.

At one time the State of Texas passed an Act which no longer required the lessors to pay half the bonuses to the State. While that particular Act was held unconstitutional it is entirely possible that the State of Texas may again pass similar legislation and Turney may never have to give up half of the bonus.

In the case at bar, petitioner was required by the terms of its contract to pay 35% of the amounts received from Shell to Shepard-Pendleton, Ltd., but the court below held that petitioner was taxable on 100% of the amount received from Shell, and the two cases are in conflict, at least as to the 35%. As shown by the dissenting opinion in the *Turney* case, it is probable that the decision is in conflict with the *Alamitos* case on the other 65% of the royalties received in litigation and returned by the petitioner herein.

5. The decision of the court below is in conflict with *Stoner v. Commissioner,* 79 Fed. (2d) 75, as to 35% of the monies received in 1932 from Shell. In the *Stoner*

case the principal stockholder of a company had entered into an agreement on behalf of all the stockholders to sell all the stock of the company for $1,250,000 with the provision that Stoner was to retain $50,000 as a tax reserve fund and after holding it for two years to turn over to all the stockholders any unused portion. The court held that he was not taxable in the year of sale on his portion of the $50,000, although the court recognized that he might have been but never was required to use the funds for the payment of the corporation taxes.

In the case at bar, the petitioner, by virtue of its contract with Shepard-Pendleton, Ltd., received the 35% from Shell as agent for Shepard-Pendleton, Ltd., and not as its own money.

6. The decision of the court below is in conflict with *Doyle v. Commissioner,* 110 Fed. (2d) 157, decided by the United States Circuit Court of Appeals for the Second Circuit on March 4, 1940. In that case the taxpayers contracted to sell in 1929 for $185,000 property which cost them $17,000. They received a down-payment in 1929 of $35,000 and a further payment in 1930 of $25,000. In 1931 when the contract was to be closed, the buyer refused to accept the deed or to pay the money. Eventually the taxpayers sued for specific performance and the buyer counter-claimed for the recovery of the $60,000 theretofore paid. In 1934 the complaint and counter-claim were both dismissed; the complaint on the ground that the plaintiffs were guilty of laches, and the counter-claim on the ground that it was grounded on a mere pretense. The taxpayer in the *Doyle* case contended that the money had been received in 1929 and 1930 under a claim of right and it, or most of it, was income in those years although there

was a possibility that it might have to be returned if there was a failure of consideration. The Circuit Court of Appeals held that the $60,000 was income in 1934 and not in any of the earlier years, although it was received in 1929 and 1930 under a claim of right and a large portion of it at least would have been taxable income even if the sale had been completed. Petition for writ of certiorari has been filed in the *Doyle* case and is waiting disposition by this Court.

7. If and to the extent that the decision below does not conflict with the above mentioned Supreme Court or Circuit Court decisions, then the Court has decided an important question of Federal law that has not been but should be decided by the Supreme Court.

The court below has decided that, where a taxpayer brings a suit for money and receives it as a result of the lower court's decision, it is income, even though he has to return it and its income in the year of restitution is wholly inadequate to absorb the deduction.

The important question here is not the year in which this item should be taxed, but is it income in the constitutional sense.

This Court, in *North American Oil Consolidated v. Burnett,* 286 U. S. 417, in a case where the taxpayer received money as a result of a decision of the lower court and was eventually permitted to keep the money, held the income taxable in the year in which received even though it was still claimed that it was not entitled to re-

tain the money. The Court (p. 424) then went on to use language which was not applicable to the facts of the case then before it, as follows:

> "* * * and even though he may still be adjudged liable to restore its equivalent * * * If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits in 1922, not from those of an earlier year * * *."

This language no doubt seemed appropriate to the court in a case in which the taxpayer was eventually permitted to keep the money, but should not of course be binding in a case where the taxpayer was required to give up the money; furthermore, it should be noted that in the *North American* case, a large corporation with many properties and large income was before the court whereas the item in dispute was relatively small in comparison with the normal income of the corporation. It was assumed that if the taxpayer had been required to give up the money in 1922 it would have had sufficient income to absorb that deduction.

In the case at bar, however, the taxpayer involved is a small corporation with an average income of around $60,000 a year while the item in dispute is over $500,000, so that if it were taxed on $500,000 extra income in 1932 but got a $500,000 reduction in 1935 or 1938 against an income of $60,000, it would be slight consolation. While the language above quoted from the *North American* case

is undoubtedly *obiter dictum,* it has been applied by the Treasury Department and by the courts in circumstances far different from those involved in the *North American* case; as for example, in the case at bar.

The *obiter dictum* in the *North American* case, rather than the holding of the case, is being applied by the Treasury Department and the lower courts to cases where its application violates the Constitution of the United States. This Court ought to consider a case where the facts involved are like those mentioned in the *dictum* (with the added factor that there is very little or no income against which to take the large deduction) and impress upon the Treasury Department and the lower courts that only the holding in the *North American* case is to be followed and to limit the application of the North American case to situations where the taxpayer received the money, and though it may be claimed that he is liable to turn it over to others, he is not later required to do so unless the size of the item was such that it would be entirely probable that he could deduct it from income in subsequent years.

The Prentice-Hall Citator shows that Point 4 in this Court's opinion in the *North American* case has been cited seventy-five times in the last eight years. It is thus apparent that the taxation of items in litigation is an important subject.

The *obiter dictum* in the *North American* case adds greatly to the confusion on the question and the case at bar affords an opportunity to clear up the subject to considerable extent and thus avoid much future litigation.

Conclusion.

Wherefore, it is respectfully submitted that this petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: August 8, 1940.

IN THE

Supreme Court of the United States

October Term, 1940

No. .....

ALAMITOS LAND COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION.

To avoid duplication, this brief is limited to argument, since the formal statements required by the rules appear *ante* as part of the petition.

ARGUMENT.

I.

The Receipt in 1932 Did Not Constitute Taxable Income in the Constitutional Sense.

Petitioner is a small corporation having an average annual income of around $60,000.

It brought suit against an oil lessee for several years back royalties and obtained a judgment in its favor for $522,895.11. Instead of permitting the defendant, Shell Oil Company, to put up a supersedeas bond, the court required Shell to pay the money to petitioner or suffer

a forfeiture of the lease. Shell paid the money to petitioner in 1932 but in doing so stated that it was under the duress of the judgment and that it expected to appeal and get it back.

Under the circumstances, petitioner in receiving the money did not treat it as its own but put it in a special bank account (with the approval of its associates in the litigation, who had a 35% interest therein), and kept it segregated throughout the litigation. On its books and returns petitioner treated the item as an amount in suspense subject to being returned. Its books also showed that Shepard-Pendleton, Ltd. had a substantial interest in the litigation, but petitioner did not turn over to Shepard-Pendleton their portion of the money, as neither considered that there had as yet been a "recovery" entitling Shepard-Pendleton to the fee.

The decision of the lower court was reversed and petitioner returned the money in 1935 with accretions. In 1938 it settled the litigation, receiving $100,000.00 and paying Shepard-Pendleton $25,000.00 and other attorneys associated in the case $2500.00.

In 1935 petitioner had a net income without regard to the litigated items of $51,498.18 and in 1938 its estimated net income without regard to the litigated items was $69,463.75.

Under the circumstances it cannot be said that in the long run petitioner realized any income out of the litigation excepting as to its portion of the $100,000 received in settlement in 1938. Petitioner is, of course, perfectly willing to pay tax on its portion of the $100,000 in whatever year it is proper to do so.

Mr. Justice Cardoza, in *United States v. Safety Car Heating and Lighting Company*, 297 U. S. 89, 99, said:

> "Income within the meaning of the Sixteenth Amendment is the fruit that is born of capital, not the potency of fruition. With few exceptions, if any, it is income as the word is known in the common speech of men. When it is that, it may be taxed, though it was in the making long before."

It may be safely asserted that if the facts in this case were stated to a thousand men on the street, hardly one of them would agree with the Government's contention that the receipt in 1932 was income to petitioner. In fact, they would be shocked, as are petitioner's stockholders and directors, at respondent's position.

This Court, in *Bowers v. Kerbaugh-Empire Company*, 271 U. S. 170, has recognized that although the annual accounting period is important, still in certain circumstances all the facts happening over a period of years must be taken into account in considering whether a taxpayer has received income in the constitutional sense.

In *Eisner v. Macomber*, 252 U. S. 189, 207, this Court defined income as:

> "* * * a gain, a profit, something of exchangeable value, proceeding from the property, severed from the capital, however invested or employed, and coming in, being 'derived'—that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal—that is, income derived from property. Nothing else answers the description."

It cannot be said that when petitioner received the money in 1932 the receipt under the circumstances of the case satisfied the conditions stated in the above definition.

The petitioner knew that it received the money under the very serious possibility that it would have to return it. It did not feel free to spend the money; did not feel free to pay the fees it had agreed to pay when there was a "recovery." It did not feel that the money had been severed or derived for its separate use, benefit or disposal.

If there were no legal limitations or restrictions upon petitioner's use of the money, there certainly was a moral and practical one.

Although the court below held that petitioner did not receive the money as trustee, it did show that, as soon as the judgment was reversed, petitioner's liability from the beginning was that of trustee, except as to disbursements out of the fund which had been legally made. Petitioner knew that if the judgment was reversed it would have the liability of a trustee and the Circuit Court's conclusion that petitioner did not receive it as a trustee is too technical and unsubstantial to overcome the fact that in the long run, petitioner did not receive any income from this litigation, excepting upon the settlement in 1938.

Petitioner received the money in 1932 under a very substantial moral and practical restriction and with the knowledge that if the judgment were reversed, a legal restriction would apply from the moment of receipt.

Under the circumstances of this case, the right to take a deduction in the year of restitution does not make the receipt in 1932 taxable income in the constitutional sense. While in form it might appear that the right to deduct

the item in dispute in the year of restitution would compensate for taxing it in the year of receipt, this is not so in the case at bar in truth and substance. This Court has held in *Eisner v. Macomber,* 252 U. S. 189, page 206, that in determining what is and what is not income, the question is to be decided according to truth and substance, without regard to form. As the Board properly said in the case at bar [Record 42]:

> "Where possible, tax cases should be decided on realities and not on abstract hypothesis."

The reality in the present case is that the petitioner would not be permitted to deduct more than a small portion of the amount paid in restitution and it is therefore merely an abstract hypothesis to say that it would be proper to tax it in the year of receipt, because the taxpayer would be permitted to deduct it in the year of restitution.

The equalization theory depended upon by the respondent does not stem from any holding of this Court in any decided case. It is based upon *obiter dictum* in the case of *North American Oil Consolidated v. Burnett,* 286 U. S. 417. As shown on pages 16-17 of the petition herein the Court in illustrating the point in issue used language applicable to facts not in the case then before it, and in doing so announced the equalization theory. The only holding in the *North American* case was that the income received by the taxpayer in 1917 and thereafter retained by it, was taxable in 1917.

It is only the holding of the Court that is binding in subsequent cases and not other language used therein.

As stated by this Court itself in *Cohens v. Virginia,* 19 U. S. 264, 399, the rule as to the effect of its former decision is as follows:

> "It is a maxim, not to be disregarded, that general expressions in every opinion are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit, when the very point is presented for decision. The reason for this maxim is obvious. The question actually before the court is investigated with care and considered in its full extent. Other principles which may serve to illustrate it are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated."

The Supreme Court of the State of Missouri, in *State v. St. Louis,* 241 Mo. 231, 238, 145 S. W. 801, 803, has well stated the rule as follows:

> "There is a pronounced line of demarcation between what is said in an opinion and what is decided by it—between arguments, illustrations and references on one side and the judgment rendered on the other. The language used by the Judge in his opinion is to be interpreted in the light of the facts and issues held in judgment in the concrete case precisely as in every other human document."

Of course the *North American* case is authority for the proposition that when a taxpayer receives money in a certain year, which money has been conceded to be

taxable income in some year, it is taxable in the year in which it is received, especially when the taxpayer is on the cash basis, even though there is a continuing claim that the money did not belong to the taxpayer. But that holding was decided in relation to a case where the taxpayer was eventually permitted to keep the money and where the money was concededly income to it in some year.

The holding in that case is not applicable to or binding upon another case where the issues are different and the facts are different. In the case at bar, the main issue is whether the money received by petitioner in 1932 and eventually given up by it is income to petitioner in the constitutional sense at all. In the *North American* case it was conceded that the money was income to the taxpayer in some year and the only issue was the year in which it was taxable, as in that case the taxpayer was permitted to retain the money. Consequently, since the facts and issues in the *North American* case were different from the facts and issues in the case at bar, the decision in that case is not decisive of the issues in the case at bar.

This Court has never held an item in litigation to be taxable income to the taxpayer in the year in which it received it as a result of a lower court's decision when the taxpayer was required to return it. The affect of the absence of a decision along this line is stated in 15 *C. J.* 916 as follows:

> "It has been held that the absence of reported judgments and decisions sustaining an alleged liability

under a given state of facts raises a strong presumption that no such liability exists." *Western Union Telegraph Company v. Schriver,* 141 Fed. 538.

The principle announced by the *obiter dictum* in the *North American* case works out so inequitably that this Court and other courts have distinguished it in several cases where the taxpayer received money but was required to give it back in later years. In *Freuler v. Helvering,* 291 U. S. 35, the beneficiaries of a trust received more money in a certain year than they were entitled to under the trust indenture and the State court required them to return it. This Court held that they were taxable only on the amount that was actually distributable to them.

In *Commissioner v. Turney,* 82 Fed. (2d) 661, the taxpayer received bonuses for granting oil leases, but it appeared that by virtue of its lease and state statutes it would probably be required to pay over half of the money to the State of Texas. Because of the fact that the chances of its giving up the money were quite certain, the Court distinguished the *North American* case, holding that it was taxable only on that portion of the bonus to which it was clearly entitled.

In *Great Southern Life Insurance Company v. Commissioner,* 89 Fed. (2d) 54, the taxpayer received interest on bonds which bonds and interest it eventually had to pay over to the rightful owner after litigation concerning the ownership. Here again the Court distinguished the *North American* case as the taxpayer was actually required to give up the income item in dispute.

Underlying these decisions is the thought that an item temporarily received but eventually returned, is not income in the constitutional sense.

II.

If the Item in Litigation Was Income to Petitioner it Represented Additional Royalties for the Period From 1921 to 1930, and Since Petitioner Kept Its Books and Made Its Returns on the Accrual Basis Additional Royalties Were Income in the Years Earned—1921 to 1930.

Petitioner kept its books and filed its returns on the accrual basis as to royalty income and since this constituted its main income producing account, it determined the character in which the entire books and returns were kept and made.

Upon the accrual basis, the time of receipt is not important, but the important fact in determining when income is to be reported is when the right to it becomes definitely determined.

If it was not necessary in this case to await the outcome of the highest court to which the litigation could go before determining that the litigated item was income to the petitioner, then the additional royalties constituted income in the months in which the oil was produced, namely, during the period from 1921 to 1930 inclusive. If the royalties were due to petitioner at all, they were due by virtue of its contract or lease with Shell. The liability for the correct royalties existed from the execution of the lease and the production of oil. Merely the amount or method of computing the royalties was in question; consequently when the method was established, the liability for the exact amount related back to the year in which the oil was produced. Compare *Lichtenberger-Ferguson Company v. Welch,* 54 Fed. (2d) 570.

In a long line of cases, the Board of Tax Appeals and the courts have consistently held that railroad companies which kept their books on an accrual basis were required

by law to report as income compensation received from the United States for the period of Governmental control in the years when actually earned even though the amount was in controversy until actually settled by payment in later years. The theory underlying these decisions is that income should be taxed for the year in which actually earned and at the tax rate then provided by law. See *Illinois Terminal Company,* 5 B. T. A. 15; *Texas and Pacific Railway Company,* 9 B. T. A. 365; *New Orleans T. & M. Railway Company,* 6 B. T. A. 436; *St. Louis and Southwestern Railroad Company,* 24 B. T. A. 917; *Western Maryland Railroad Company,* 12 B. T. A. 889; *Continental Tie and Lumber Company v. U. S.,* 52 Fed. (2d) 1045; *Commissioner v. Brooklyn Union Gas Company,* 62 Fed. (2d) 505; *Helvering v. Gulf M. & N. Railroad Company,* 71 Fed. (2d) 953.

In other situations, the Board of Tax Appeals and the courts have held that money received in one year was taxable income in an earlier year on the accrual basis. See *C. C. Harris Oil Company,* 13 B. T. A. 937; *Thomas D. Taylor,* 13 B. T. A. 1107, affirmed 51 Fed. (2d) 915, certiorari denied, rehearing denied; *John B. Ford,* 19 B. T. A 1143, affirmed 51 Fed. (2d) 206, certiorari denied, 284 U. S. 666; *Percy K. Hexter,* 8 B. T. A. 888.

The idea underlying the above cases is that the right existed from the earlier point of time, subsequent events merely confirming an already existing right.

If the payment in 1932 can be said to be income to petitioner at all, then since Shell agreed by the lease executed in 1921 to pay royalties to petitioner in amounts to be determined by each month's production, the correct amount of royalties constitutes taxable income to petitioner on the accrual basis in the year in which the oil was produced, namely, 1921 to 1930.

III.

If the Receipt in 1932 Constituted Taxable Income, Then Petitioner Should Only be Taxable on 65% Thereof as the Other 35% Belonged to Shepard-Pendleton.

Before the litigation with Shell was started, petitioner signed an agreement with Shepard-Pendleton, Ltd. to pay them 35% of any recovery obtained from Shell, through litigation or otherwise. Consequently, when petitioner received monies from Shell in 1932, 35% thereof was received by it as agent or trustee for Shepard-Pendleton and not as its own money.

This result should follow both under the law of California and under Federal decisions.

It is the law in California that where an executory contract is made between two parties, that one should have as compensation for services rendered to the other, a stipulated percentage of the proceeds of the judgment to be recovered for the other, the contract operates as an equitable assignment *pro tanto*. *Hoffman v. Vallejo,* 45 Cal. 564; *Luco v. DeToro,* 91 Cal. 405, 27 Pac. 1082; *Elliott v. Leopold Mining Company,* 53 Cal. 355. To the same effect, generally, see *Wooster v. Trowbridge,* 120 Fed. 667; *Hawk v. Ament,* 28 Ill. App. 390; *Briband v. Candler,* 166 Mich. 49, 131 N. W. 129; *Bent v. Lipcomb,* 45 W. Va. 183, 31 S. E. 908; *Curtis v. Metropolitan Street Railway Company,* 118 Mo. App. 34, 94 S. W. 762; *Texas C. R. Co. v. Andrews,* 28 Tex. Civil Appeals 477, 67 S. W. 923; *Coughlin v. N. Y. C. and H. R. R. Company,* 71 N. Y. 443, 2 A. L. R. 454.

As a result of the agreement between petitioner and Shepard-Pendleton and the law of California, Shepard-Pendleton had a 35% interest in the litigation and if any income was realized at all in 1932, 35% thereof was income to Shepard-Pendleton and only 65% to petitioner.

This same result would follow under several Federal decisions. For example, *Commissioner v. Turney,* 82 Fed. (2d) 661; *Stoner v. Commissioner,* 79 Fed. (2d) 75. In the *Turney* case the taxpayer received an oil bonus which, by virtue of its lease and state statutes, it was bound to turn over to the State of Texas. The court held that it was taxable only on the portion which it was entitled to keep and was not taxable on the portion which was required to but had not been turned over to the State of Texas. In the *Stoner* case the taxpayer was the principal stockholder of a corporation and he agreed to sell all of the stock of the company, with the further provision that he was to retain a $50,000.00 tax reserve fund for two years. If at the end of that time any of it was left after paying taxes of the corporation, he would turn it over to all the stockholders. The court held that he was not taxable in the year of sale on any portion of the $50,000.00 as he held it for the benefit of all the stockholders.

The court below, in the case at bar, was therefore in error in not in any event excluding 35% of the receipt from Shell from petitioner's taxable income in the year 1932. See *Lowery v. Helvering,* 70 Fed. (2d) 713; *Byrnes v. Commissioner,* 89 Fed. (2d) 243; *Commissioner v. Ross,* 83 Fed. (2d) 18; *Helvering v. Sestree,* 72 Fed.

(2d) 67; *Hall v. Burnet,* 54 Fed. (2d) 443; *Nelson v. Flagman,* 56 Fed. (2d) 121.

To further illustrate the great injustice which might be done by following the *obiter dictum* in the *North American* case rather than the holding of that case, the Commissioner wishes to include 100% of the receipt from Shell in 1932 as taxable income of petitioner but does not wish to allow as an exclusion or as a deduction the 35% which was due to be paid to Shepard-Pendleton upon a recovery. In other words, the Commissioner says that the receipt was such a recovery as to constitute taxable income to petitioner but was not such a recovery as to constitute a liability of petitioner to pay Shepard-Pendleton, because petitioner would not be required to pay Shepard-Pendleton unless and until the state court eventually held that petitioner was entitled as between it and Shell to keep the money.

Any language in a Supreme Court decision which makes such an inequitable proposition technically tenable and arguable should be re-examined by this Court.

IV.

Interest on the Shell Fund Should Follow the Fund, and Since the Fund Was Not Taxable to Petitioner Upon Its Receipt in 1932, the Interest on the Fund Should Not Be Taxable to Petitioner in 1932 or 1933.

This point is self explanatory and will not be further argued here.

The court below did not discuss this point but impliedly approved the respondent's inclusion of the interest on the fund accrued in 1932 and 1933 in petitioner's taxable income for those years.

Since petitioner did not receive any income in the constitutional sense from the receipt from Shell in 1932, and since petitioner was required to return to Shell the interest on the impounded fund, petitioner received no taxable income on account of that interest.

V.

The Question Involved Is of Such Importance That a Writ of Certiorari Should be Granted.

If this Court should consider that the decision of the lower court is not in conflict with one or more of the Supreme Court cases cited herein, or with the Circuit Court cases cited herein, then the Circuit Court of Appeals has decided an important question of Federal law which has not been but should be settled by this Court.

It is apparent from the respondent's position in this case, both with respect to the receipt of the money in 1932 and the treatment of the 35% payable to Shepard-Pendleton, Ltd. that the *obiter dictum* in the *North American* case makes it possible for the Commissioner to propose and the courts to hold taxpayers taxable on items which do not constitute income in the constitutional sense.

Inasmuch as the decisions of the Circuit Court of Appeals are in most cases final, it is apparent that great injustice may be done to many taxpayers unless the confusion created by the *obiter dictum* is corrected.

It is submitted that the Commissioner and the court below were over-impressed by the language in the Supreme Court decision, even though that language is *obiter dictum* and these lower tribunals should again be instructed on the effect of the former decisions of this Court.

The result which the respondent seeks in this case and which the Circuit Court has allowed is shocking to the

stockholders and directors of petitioner and will be shocking to all others who read the Circuit Court's decision. Unless the great injustice resulting from the Circuit Court's decision is corrected by this Court, great injury will be done to the confidence of the taxpaying public in the attitude of the Commissioner and of the courts.

Furthermore, as shown in the petition, a great number of cases involve items in litigation and practically all of them cite or refer to or attempt to distinguish the decision in the *North American* case and particularly the *obiter dictum* therein, and unless the limitation to which the holding in that case may be applied is determined by this Court, much future litigation will ensue and probably much continued inequity, hardship and injustice on taxpayers will follow.

It is therefore respectfully submitted that the petition should be granted.

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Counsel for Petitioner.

August 8, 1940.

Due service of the within Petition and Brief is hereby acknowledged this.....day of August, A. D. 1940.

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Counsel for Respondent.

8-8-40—65

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257773—40

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 335

ALAMITOS LAND COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 23–50) is reported in 40 B. T. A. 353. The opinion of the Circuit Court of Appeals (R. 138–148) is reported in 112 F. (2d) 648.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 10, 1940 (R. 149). The petition for a writ of certiorari was filed on August 13, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the petitioner realized taxable income in 1932 when its lessee paid the petitioner $522,895.11 pursuant to a judgment of the Superior Court of California which was reversed in 1935 by the Supreme Court of California.

2. Whether interest received by the petitioner in 1932 and 1933 on the fund of $522,895.11 was taxable income.[1]

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, * * * of whatever kind and in whatever form paid, or from * * * businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

[1] A further question was presented to but not decided by the Board of Tax Appeals or the Circuit Court of Appeals, namely, whether, if the judgment was taxable income in 1932, a deduction may be taken in that year for a contingent fee which the petitioner had agreed to pay in an amount equal to 35 percent of the recovery from its lessee. The case was remanded to the Board of Tax Appeals for a decision of this point.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

STATEMENT

The pertinent facts as stipulated and found by the Board of Tax Appeals (R. 25–36) are as follows:

In 1921, the petitioner, as lessor, entered into an oil and gas lease with the Shell Oil Company of California, hereinafter called Shell. Under the terms of the lease, the petitioner was to receive 16⅔ percent of all oil and gas produced from the leased property. Oil and gas have been produced upon the property by the lessee since 1921, and each year the petitioner has accrued on its books and in its income-tax return the December royalty, payable in January (R. 25).

On September 1, 1930, the petitioner entered into a contract with Shepard-Pendleton, Ltd., a corporation engaged in petroleum engineering work, pursuant to which the latter was employed to check the methods which Shell had used in determining the quantity and quality of the oil produced from the leased premises and the method of computing the royalties to be paid to the petitioner. The petitioner agreed to pay Shepard-Pendleton for its

services a sum equal to 35 percent of the amount recovered from Shell, whether with or without litigation. Shepard-Pendleton was to pay all attorney's fees and court costs (R. 25–26).

As Shepard-Pendleton determined that, due to Shell's incorrect method, the latter owed the petitioner about a half million dollars, the petitioner brought suit in the Superior Court of California in 1931 against Shell for this sum and also asked for the forfeiture of the lease because of Shell's failure to pay the proper royalties (R. 26–27). On June 20, 1932, judgment was entered in favor of the petitioner for additional royalties in the amount of $490,805.75, interest in the amount of $31,226.86, and court costs of $862.50. The judgment also ordered cancellation of the lease but provided that Shell might be relieved of such forfeiture if it paid the petitioner the sums allowed by the judgment on or before August 29, 1932 (R. 27).

The lease involved was very valuable to the lessee, and, to prevent a forfeiture, Shell, on July 8, 1932, tendered to the petitioner a cashier's check for $522,895.11. Accompanying the check was a letter from Shell to the petitioner, in which it was stated that the payment was made only to avoid a forfeiture of the lease and that Shell was not waiving its right of appeal for the purpose of securing a reversal of the judgment (R. 28).

On July 12, 1932, the petitioner, through its attorneys, wrote a letter to the attorneys for Shell in

which it was stated that the payment by Shell would be considered as precluding an appeal from the judgment. It also stated that if Shell attempted to appeal, the petitioner would move to dismiss the appeal upon the ground that the judgment had been satisfied by the payment. The petitioner offered to return to Shell the $522,895.11, if Shell felt that its interests might be prejudiced by having made the payment. Shell did not agree with the conditions expressed by the petitioner and did not ask for the return of the money (R. 28–29).

On July 14, 1932, Shell took an appeal to the Supreme Court of California from all portions of the judgment with the exception of paragraphs sixth and seventh as to which the petitioner took a cross appeal, but its motion was denied on January 9, 1933 (R. 29).

On September 22, 1932, the petitioner deposited the check for $522,895.11 in the Long Beach Branch of Security-First National Bank of Los Angeles in a term deposit account bearing interest at the rate of 3½ percent per annum. On its books, the petitioner made a journal entry debiting "Deposit in connection with pending action vs. Shell Oil Co.—$522,895.11" and crediting "Reserve for contingent liability in connection with pending action vs. Shell Oil Co.—$522,895.11." This was followed by a statement explaining the conditions under which Shell had made the payment. On June 14, 1933, the petitioner, out of the funds so deposited, purchased

United States Treasury Notes for $52,000, and on July 24, 1933, purchased Treasury Notes for $205,000 (R. 29–31).

On April 26, 1935, the Supreme Court of California reversed the judgment of the lower court in its entirety except that it affirmed the judgment as to paragraphs sixth and seventh (R. 31).

On May 28, 1935, Shell made a written demand upon the petitioner for restitution, demanding repayment of the sum of $522,895.11, together with interest at 7 percent amounting to $105,696.44. On June 4, 1935, the petitioner tendered to Shell the sum of $522,895.11, plus $41,256.90, being the interest actually received by the petitioner during the time the principal had been in the petitioner's custody, and the sum of $11,595.31, representing profits accruing from the purchase and sale of United States Treasury Notes, or a total of $575,747.32. The petitioner gave to Shell a complete accounting of the $522,895.11 while in the petitioner's custody (R. 31–32).

After receiving the petitioner's check for $575,747.32, Shell sued the petitioner for the additional sum it claimed as due. Also, subsequent to the Supreme Court's decision, the petitioner filed an amended complaint against Shell and Shell filed an answer and the case was at issue in 1938. While these suits were awaiting trial, the parties entered into an agreement in 1938 whereby the petitioner received $100,000 and both actions were dismissed (R. 32, 34–35).

Before entering into the settlement, the petitioner obtained the consent thereto of Shepard-Pendleton and agreed to pay the latter 25 percent of the $100,000 as its fee. This sum was paid Shepard-Pendleton in 1938 as its fee in the litigation against Shell (R. 35).

In its 1932 income-tax return, the petitioner excluded from income the $522,895.11 received from Shell and the interest earned thereon and did not deduct the sum of $182,205.76 representing its contingent liability to Shepard-Pendleton. In its 1933 return, the petitioner also excluded an $18,208.57 increase in the deposit account (R. 35).

On its 1935 return, the petitioner did not claim any deduction on account of having returned to Shell the $522,895.11, plus accretions, but paid an income tax for the year 1935 of $7,081. The petitioner, within the statutory period allowed therefor, filed a claim for refund which had not been acted upon at the time of the Board's hearing (R. 36).

During 1932 and 1933, the petitioner kept its books and filed its income-tax returns on the accrual basis as to royalties (R. 36).

The Board held that the fund of $522,895.11 and the accretions thereto in 1932 and 1933 were not income to the petitioner in those years. In view of this decision, the Board stated that it was not necessary to consider whether, if these sums had constituted income, petitioner would have been entitled to a deduction in the amount of its contingent lia-

bility to Shepard-Pendleton (R. 44). An order was entered determining that there was no deficiency due in 1932 and 1933 (R. 50).

The Circuit Court of Appeals held that the amount of the judgment should be included in petitioner's gross income. It therefore reversed the order of the Board and remanded the case for determination of the question of petitioner's right to a deduction because of its contingent liability to Shepard-Pendleton (R. 145, 148).

ARGUMENT

1. The question presented in this case has already been decided by this Court in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417. The petition suggests no persuasive reason why the issue settled in the *North American Oil* case should now be reexamined.

The facts in the *North American Oil* case are strikingly similar to those in the case at bar. The taxpayer there operated oil land, the legal title to which stood in the name of the United States. The Government, claiming also the beneficial ownership, instituted suit to oust the taxpayer from possession and, prior to 1916, secured the appointment of a receiver to operate the property. In 1917 the Government's bill was dismissed by the District Court and in the same year the receiver paid to the taxpayer the net profits which had been earned from the property in 1916. The Government took an appeal, without *supersedeas*. In

1920 the Circuit Court of Appeals affirmed the decree of the District Court, and in 1922 a further appeal to this Court was dismissed by stipulation.

The Commissioner determined that the amount paid to the taxpayer by the receiver in 1917 was income to it for that year. The company contended, on the other hand, that the money was income either for 1916, when earned, or for 1922, when the litigation was finally determined. It urged that in 1917 it was not known whether the decree of the District Court would be affirmed or reversed and that, because of the possibility of reversal, the money paid pursuant to the decree could not be considered income until the litigation was at an end. The Court, holding that the taxpayer received the income in 1917, stated (286 U. S. 424):

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. [Citing cases.] If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year * * *.

Petitioner urges that the *North American Oil* case is distinguishable because there the original

decree was ultimately affirmed while here it was reversed. The contention misconceives the basis of this Court's ruling. The taxability of income in any particular accounting period depends solely on the situation existing in that period and cannot be affected by what happens during a subsequent accounting period. Thus, the taxability of the North American Oil Consolidated on the funds it received in 1917 was dependent upon the situation then existent and could not be altered by what occurred in a later year. Looked at from the standpoint of 1917 there was the same possibility that the decree in favor of the North American Oil Consolidated would be reversed and that the company would have to restore the funds which it received as, in the present case, there was the possibility in 1932 that the judgment in favor of the taxpayer would be reversed and the amount received would have to be repaid. But this Court held that the possibility of reversal, with the consequent liability for repayment, did not affect the situation; the controlling factor was that the taxpayer had received the money during the tax year under a claim of right and without restriction as to its disposition.[2]

Here, too, the taxpayer received the money during the tax year under a claim of right and without

[2] Accord: *Brown* v. *Helvering*, 291 U. S. 193; *Commissioner* v. *Brooklyn Union Gas Co.*, 62 F. (2d) 505 (C. C. A. 2d); *Commissioner* v. *Lyon*, 97 F. (2d) 70 (C. C. A. 9th); *Board* v. *Commissioner*, 51 F. (2d) 73 (C. C. A. 6th), certiorari denied, 284 U. S. 658; *Saunders* v. *Commissioner*, 101

restriction as to its disposition. As pointed out by the court below, under the law of California petitioner was not a trustee of the fund while the litigation was in progress but had the right to use the money in any fashion that it saw fit. *Oldfield* v. *Bank of America Etc. Assn.*, 6 Cal. (2d Series) 103; *Garrett* v. *Jensen*, 44 Cal. App. 99. The fact that petitioner decided not to exercise its power of absolute dominion over the fund but instead placed it in a special deposit account did not change the character of the control which it had over the money when it received it. Consequently, the rule in the *North American Oil* case is, as the court below held, directly applicable.

2. Petitioner contends that the decision below is in conflict with four decisions of this Court. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170; *Freuler* v. *Helvering*, 291 U. S. 35; *United States* v. *Safety Car Heating and Lighting Co.*, 297 U. S. 88; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359. No useful purpose would be served by pointing out the obvious distinctions between those cases and the present one. It suffices to note that two of the cases were decided before the decision in the *North American Oil* case and were not deemed to affect the result, and that in the other two the *North American Oil* decision was either cited with approval or specifically held inapplicable. 291 U. S.

F. (2d) 407 (C. C. A. 10th); *Victoria Paper Mills Co.* v. *Commissioner*, 32 B. T. A. 666, affirmed without opinion, 83 F. (2d) 1022 (C. C. A. 2d).

at 42–43; 297 U. S. at 94. Since, as we have shown, the decision below is directly in accord with the decision in the *North American Oil* case, it cannot successfully be maintained that it is in conflict with the other cases cited.

3. Petitioner's contention that the decision in the present case is in conflict with decision of other circuit courts of appeals has no greater merit.

In *Great Southern Life Ins. Co.* v. *Commissioner,* 33 B. T. A. 512, affirmed on other grounds, 89 F. (2d) 54 (C. C. A. 5th), the taxpayer held bonds as collateral for a loan. Upon nonpayment of the loan, the taxpayer appropriated the collateral for its own use and thereafter received various sums as interest upon the bonds. Prior to the appropriation, however, the taxpayer had received notice that certain of the bonds were stolen property and it ultimately had to return those bonds to the true owner. The Board held that the taxpayer was not liable for income tax on the interest paid on the bonds because it did not receive the payments under a claim of right and without restriction as to their disposition. *North American Oil Consolidated* v. *Burnet, supra,* was expressly distinguished.

In *Commissioner* v. *Turney,* 82 F. (2d) 661 (C. C. A. 5th), the taxpayer received certain payments under oil and gas leases, one-half of which he was under firm obligation to pay over to the state. The court held that the taxpayer was liable for income tax only on one-half of the payments received be-

cause he had received the other half under no claim of right but merely as agent for the state. In this case, too, the *North American Oil* decision was expressly distinguished.

In *Stoner* v. *Commissioner,* 79 F. (2d) 75 (C. C. A. 3rd), the holding was merely that the payments to the taxpayer sought to be taxed were received by him in a fiduciary capacity and that during the tax year he had no absolute power of disposition over the fund.

In *Doyle* v. *Commissioner,* 110 F. (2d) 157 (C. C. A. 2d), petition for certiorari pending, October Term, 1940, No. 111, the taxpayers had contracted to sell a house which they owned prior to 1913. They received payments on account of the purchase price in 1929 and 1930 (the payments amounting to less than the 1913 value of the house), but the purchaser ultimately decided not to go through with the contract. In 1934, a suit for specific performance of the contract was decided against the taxpayers, but it was determined that they were entitled to keep the payments previously made. The court held that the payments were income subject to tax in 1934. It pointed out that in 1929 and 1930 the contract was still in the executory stage, the sale was not intended to be closed until a later year, and the payments consequently could not then be considered income rather than a return of capital. Only when the contract was finally ended in 1934 by the decree fixing the rights of the parties were the payments severed from a prospective sale

of the property and realized as a clear profit. Consequently, the payments became income only in 1934 and were taxable as such in that year.

4. The court below did not decide whether or not petitioner was entitled to a deduction because of its contingent liability to Shepard-Pendleton, but remanded the case to the Board for a determination of that question. Consequently, the issue cannot now be presented to this Court and petitioner's contention that, under California law, its agreement with Shepard-Pendleton constituted an equitable assignment of a portion of the recovery (Pet. 12) is not relevant to the disposition of the petition for certiorari.

CONCLUSION

The decision below correctly applies the rule of *North American Oil Consolidated* v. *Burnet, supra,* and is not in conflict with any decision of this Court or of any other circuit court of appeals. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted.

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